Best Practice Process Standards

By David Williams

A paper[1] on “best practice” faces the challenge of reality. There is not much value in a bundle of theories. The questions I set out to answer were:

- Is best practice achievable?
- If so, how should one achieve it?
- What are the practical benefits?

What is best practice?

My definition of best practice is outcome-based and client focused.

Best practice results when clients can give their properly informed commitment to the strategies their financial plan proposes.

The key phrase is “properly informed commitment”. I am reminded of the old argument between the pig and the hen over who contributed the most to the farmer’s traditional breakfast of bacon and eggs (this was an Australian farmer of course). After some debate the pig won the day – as it said to the hen “ you may well be involved by laying the egg, but in providing the bacon, I am totally committed”. To obtain the commitment of the client to a financial plan is the ultimate test of its quality. Importantly, it means the client owns the outcome, not just the adviser – a very important issue, as I will explain later.

Commitment without understanding is likely to be (in the context of financial planning) merely the end product of a manipulative sales process. This is why “properly informed” is a necessary requirement of our definition.

Implicit in “properly informed” is the understanding that the process of obtaining commitment complies with appropriate minimum standards for financial planning services. These standards will reflect local regulatory requirements. They may in due course be harmonized with international standards under development through the International Organization for Standardization (ISO).

This definition in effect says “if the client is properly informed and happy with the outcome proposed, then the plan is likely to be best practice”. It is clearly achievable, so I have answered my first question.

How should best practice be achieved?

I should explain at the outset that I am taking a view of “personal financial planning” that is rather less expansive than some people in the industry might prefer. I believe that the term “personal financial planning” has been steadily broadened to cover many things that are important and need to be done properly, but which are not strictly “personal financial planning”. As a result, both financial planners and their clients suffer from unclear expectations. Confusion, inefficiency and even legal disputes result.

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[1] This paper results from an invitation to the author to present to the Institute of Financial Planners of Hong Kong at their Forum on 12 February 2003.

I prefer a definition that says "personal financial planning is the making of a plan about personal finances to achieve life goals". Such a plan can be made by anyone. However, a person is likely to need assistance, and this assistance should be available only from properly trained and authorized people. Using this concept, the role of the planner is not diminished but the ownership of the outcome by the client is enhanced.

Other services that many planners offer are important (such as choosing and executing investments and selling other services and products). Planners should be able to offer these services subject to being properly trained in them. However the more precise definition I prefer encourages consumers to embrace personal financial planning as their responsibility. This should result in a far greater commitment to the process of achieving their goals.

Four Key Process Elements

With this definition in mind, four key process elements to be managed are

- Comprehensive personal information
- Clear goals
- Risk tolerance assessment and gap analysis
- Strategy development

Comprehensive personal information is a basic and typically well-understood requirement so I will not discuss it further. This is of course a two-way process – both the adviser and the client need to be frank and explicit in sharing the key information about each other.

Goal setting is a critical area for achieving "informed commitment". Goals must be clear and realistic. To achieve this may require the planner and client to review and reset the goals because constraints and opportunities emerge that were not originally envisaged. This is one area where the planner's active involvement really gets them close to understanding the client. Poor planners tend to simply accept the client's stated goals. Such an approach denies both the client and the planner the chance of a good outcome.

Risk tolerance assessment and gap analysis are relatively new concepts. In Australia, advisers are required by law to take account of a client's tolerance for financial risk in preparing their recommendations. The problem has been a lack until recently of reliable, objective ways of measuring personal tolerance for financial risk.

The industry has for many years used "portfolio pickers". A "portfolio picker" asks a mix of questions about the client's investment experience, risk tolerance, situation, time horizon etc and produces a recommendation of where the client's investment strategy should sit on the Defensive/Growth continuum. It often adds a brief description of the characteristics of the recommended strategy and the type of individual it is thought to suit.

This kind of "lump it all together" process is now becoming discredited. It is unsatisfactory because it does not separate risk tolerance from the risk in a strategy in a way that allows useful discussion.

Better ways of assessing financial risk tolerance have recently been developed.

It is now possible to accurately "score" a person's financial risk tolerance in relation to the wider population, and to relate that score to the relative aggressiveness of a portfolio. It is also possible to relate the person's financial goals over time to the relative aggressiveness of an investment strategy (more about this later). If there is a gap between what the goals require and what the person is comfortable with, the person is able to decide whether to change the goals to be more

or less aggressive, or to accept that they may be taking more or less risk than they are comfortable with. This process is critical to obtaining the "properly informed commitment" which is the core of best practice. It is particularly useful with couples when attempting to reconcile differing levels of comfort with risk.

Some experienced advisers argue that they can achieve this result by very careful education and management of their clients' expectations. While this can be possible, it seems to me to be much less certain of a reliable result and certainly harder to justify to a court of law than the simple objective process I have outlined above.

At this point I should declare an interest in this issue. An Australian company with whom I am associated, ProQuest, has developed just such a scoring system that is now in active use in Australia and New Zealand. It has just been released in the USA and is rapidly being taken up there by experienced advisers who see it as a long awaited solution to an important problem for planners and their clients, and a major step forward in protecting the legal liabilities of advisory businesses. For more information about ProQuest you can visit *www.risk-profiling.com* (where this paper can also be found).

Strategy development is the fourth key success element. It relies on good understanding of issues such as tax, investment behaviour, social security, estate planning and risk protection products.

An issue that some advisers tend to underestimate is the importance of well-designed illustrations. Quite a few planners in Australia refuse to provide illustrations because they are concerned about the risk of them being taken as a forecast. I think such a view is irresponsible. A best practice plan must use illustrations of possible outcomes, where the assumptions are clearly identified and the presentations give some indication of the probability of the outcomes that are being considered.

Modelling software will no doubt continue to be improved, but what is already available (typically incorporating Monte Carlo modelling techniques) should be well understood and used by best practice advisers.

Key Business Elements in Best Practice

Best practice advisers will be paying attention to the following key elements of their business:

1. Market Positioning

No one can know it all. Effective market positioning of an advisory practice very clearly identifies both the competencies required of the adviser and the attributes clients are more likely to possess. This gives a special focus to the business that brings with it many efficiencies.

An example of this is a business in Australia called RetireInvest. I was a director of RetireInvest from its early days until it was taken over by ING. I was variously responsible for Marketing and for Investment Management. We positioned RetireInvest very carefully. Our preferred clients were over 55 and ready to invest (typically approaching retirement) and who were in the market segment which was people who wanted the involvement of an adviser in managing their affairs, rather that doing it all themselves.

This positioning enabled us to concentrate our planning systems, adviser training and product selection on the needs of this particular group. RetireInvest became Australia's

most successful independent franchised advisory network at the time of its acquisition by ING in 1996 with 100 offices and 240 advisers and ample scope for further rapid growth.

2. Straight-through Business Platform

A straight-through business platform combines financial planning software with execution and administration platforms. It is fair to say much has been promised but not much delivered in this area. However, I am strongly of the view that a straight-through business platform is an essential element of best practice advising.

Administration systems that accept and manage a range of client investments within different tax structures have been around for a while, as has good planning software. The challenge in Australia has been to link them. An important factor often overlooked is that for linkage to be productive, the data used in the planning software has to be of "bank quality" in order to drive the administration system and give real economies of scale. This requires much closer attention to detail than many advisers are used to giving. However, those that resolve this problem will be able to share in the economies of scale that large platforms provide and also improve their services to their clients.

An important attribute of the straight-through platforms will be the ability to fully integrate customer relationship management, compliance, productivity management and other business requirements through the one system.

A business with which I am associated (Diversified Portfolio Managers Limited) is promoting this concept in Australia to independent financial services licensees. It is based on the newly upgraded and expanded Navigator platform. We aim to provide both efficiencies and access to scale that will enable these typically smaller independently-owned offices to compete effectively with large institutionally-owned advisory networks. You can find out more about our ideas at www.dpml.com.au

3. Effective liability sharing

Best practice advisers will - by my definition at the start of this paper - automatically be sharing the liability for outcomes with their clients. As well as being ethically and culturally appropriate, this sharing will considerably reduce the likelihood of clients seeking to sue their advisers. Legal actions against advisers are increasing in Australia, especially (although not totally) due to the recent market malaise. By empowering clients, liability sharing will increasingly protect advisers.

However, other "shifting" of liability should be considered too. Suppliers of research, software and financial products should all be contracted appropriately so that they stand behind their offerings. This process protects the advisor (and of course the client) and will improve the standard of the services and products provided.

With both these elements in place, and the ability to demonstrate the attention to process I advocate earlier in this paper, advisory businesses will more easily be able to negotiate pricing for Professional Indemnity insurance. In Australia this is still a major issue and already some businesses are either sub-economic or unable to retain their licenses because they have not dealt effectively with the issues involved.

4. Elegant review process

In earlier days some advisers actively campaigned against offering clients more than just a cursory review service. Thankfully those days have changed, but many advisers do not appreciate the power of these services in retaining satisfied clients and attracting new ones by referral. Reliable fast information easily integrated into the advisers desktop systems will be one of the bonuses of the straight-through platforms I mentioned earlier.

Practical Benefits

The benefits of best practice of the kind I have described are immense. To list just a few:

- High productivity in the advisory office
- Clients who are low maintenance and highly committed
- High referral rate of new clients, reducing marketing costs
- Low risk of legal or professional misconduct claims and much lower Professional Indemnity insurance costs
- A more profitable and more saleable business

Finally, my experience is that commitment to the kind of best practice I have outlined brings with it the approval and trust of satisfied clients, and a more fulfilling and enjoyable business life.

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